INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	3
Argument	4
Conclusion	8

CITATIONS

Cases:

Commissioner v. *Fleming*, 82 F. 2d 321 6
Commissioner v. *Glenshaw Glass Co.*, 348 U.S. 426 5
Community T.V. Assn. of Havre v. *United States*, 203 F. Supp. 270 6
Eisner v. *Macomber*, 252 U.S. 189 6
James Hotel Co. v. *Commissioner*, (C.A. 10th) decided November 29, 1963 6
Nichols v. *Fifteenth Street Inv. Co.*, 165 F. 2d 289 6
United Grocers, Ltd. v. *United States*, 308 F. 2d 631 6

Statutes:

Corporations Code, 25 West's Annotated California Codes:
Secs. 9000-9802 5
Sec. 9200 5

Internal Revenue Code of 1954:
Sec. 61(a) (26 U.S.C. 61 (a)) 2, 4
Sec. 118 (26 U.S.C. 118) 4
Sec. 1032 (26 U.S.C. 1032) 2, 4

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 777

AFFILIATED GOVERNMENT EMPLOYEES' DISTRIBUTING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. App. 16-33) is reported at 37 T.C. 909. The opinion of the court of appeals (Pet. App. 3-15) is reported at 322 F. 2d 872.

JURISDICTION

The judgment of the court of appeals was entered on September 16, 1963. (R. 184.) Petitioner was

granted an extension of time within which to file its petition for a writ of certiorari to and including January 22, 1964. The petition was filed on January 22, 1964. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Whether the membership fees paid to the taxpayer by its members, for the privilege of buying goods at the taxpayer's stores at a discount, were includible in the taxpayer's gross income as compensation for services or were exempt from taxation as amounts received in exchange for stock.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

* * * *

(26 U.S.C. 61.)

SEC. 1032. EXCHANGE OF STOCK FOR PROPERTY.

(a) *Nonrecognition of Gain or Loss.*—No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange

for stock (including treasury stock) of such corporation.

* * * * *

(26 U.S.C. 1032.)

STATEMENT

Taxpayer, a nonstock membership corporation, was organized in 1953 under the General Nonprofit Corporation Law of California and, during the years in question, was engaged in the retail sale of consumer goods at discounted prices to its members and their guests (Pet. App. 4). Membership in the corporation was limited generally to government employees—who paid a fee of $2—and to veterans—for a fee of $3 (Pet. App. 5).

Memberships were for life, terminated automatically upon death; they were nontransferable and were represented by a wallet-sized pass card which was used to identify the holder for admittance to taxpayer's stores. Memberships were subject to revocation for any cause deemed sufficient and refunds of the fee either upon death or resignation were within the discretion of the board of directors. Members had the right to vote for management and the right to share in assets upon dissolution, but they did not share in the profits or in the potential growth of the corporation during its life (Pet. App. 13).

Taxpayer failed to include the membership fees in its gross income for the periods in question and the Commissioner assessed deficiencies against it—$26,718.64 for the fiscal year ended June 30, 1956, and $46,188.48 for the fiscal year ended June 30, 1957—

on the ground that the fees were properly includible in gross income as compensation for services (Pet. App. 16-17, 18). In the Tax Court, taxpayer contended that the membership fees were exempt from taxation—either as contributions to capital under Section 118 of the 1954 Code or as amounts received in exchange for stock under Section 1032 (Pet. App. 30-31). The Tax Court found that the fees were paid for the privilege of shopping at taxpayer's stores and did not qualify for either exemption (Pet. App. 32). In the court of appeals, taxpayer conceded that the fees were not contributions to capital, but contended that the Tax Court erred in failing to find that the fees were received in exchange for stock (Pet. App. 3). The court of appeals affirmed on the ground that the membership fees were received in exchange for the privilege of shopping at taxpayer's stores at a discount and "were thus paid solely for direct benefits to be received" from the taxpayer (Pet. App. 15).

ARGUMENT

The decision below is correct and, contrary to taxpayer's assertions, no conflict of decisions or constitutional issue is involved.

According to Section 61(a) of the Internal Revenue Code of 1954, *supra*, p. 2, "gross income means all income from whatever source derived, including * * * compensation for services" and this Court has repeatedly held that the broad language of this provision reflects the intent of Congress to exert "the full

measure of its taxing power" and to "tax all gains except those specifically exempted". *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429-430. The taxpayer in the instant case is a nonstock membership corporation organized under the California General Nonprofit Corporation Law. See Corporations Code, 25 West's Annotated California Codes, Sections 9000-9802. Section 9200 of that code provides that a nonprofit corporation may be formed for religious, charitable, social and educational purposes, as well as for the purpose of "rendering services." Taxpayer renders a service to its members by making available to them, through the medium of mass buying power, a broad line of consumer goods at lower prices than could be obtained through normal retail outlets (Pet. App. 8, 31). It acts, in a sense, as a conduit or agent through which many individual consumers are enabled to pool their buying power in order that goods may be purchased by the group in larger quantities at lower prices, with a resulting saving to each individual member. A qualified individual who wishes to avail himself of the taxpayer's service is required to pay a two or three dollar membership fee. Though he receives a membership card which serves the purpose of identifying him as a member in order that he may enter taxpayer's stores and make purchases at a discount (Pet. App. 8), it is readily apparent, as both courts below concluded (Pet. App. 13-15, 31-32), that the membership fees received by the taxpayer were paid by the members for the privilege of shopping at taxpayer's stores at a discount, and were

therefore properly includible in taxpayer's gross income as compensation for services under Section 61 (a)(1). See *United Grocers, Ltd.* v. *United States*, 308 F. 2d 634 (C.A. 9th); *James Hotel Co.* v. *Commissioner*, (C.A. 10th) decided November 29, 1963 (12 A.F.T.R. 2d 6035); *Community T.V. Assn. of Havre* v. *United States*, 203 F. Supp. 270 (D. Mont.).

Taxpayer's principal contention is that taxing the membership fees is unconstitutional and that the decision below is in conflict with a decision of this Court and decisions of other courts of appeal.* The argument is premised on the erroneous assumption that the fees were received in exchange for stock and therefore represent equity capital. But the fact is that, while the memberships had some of the indicia of stock—i.e., the right to vote and to share in assets on liquidation—these factors, when examined in context, were insufficient to elevate the members to the dignity of stockholders and to negate what were, in substance, payments made for services rendered. The relationship between taxpayer and its members was that of merchant-customer, the membership fee was small, and refund of the fee either upon death or resignation was solely within the discretion of the board of directors. Memberships terminated automatically upon the death of a member and members

* The cases cited (Pet. 6-7), *Eisner* v. *Macomber*, 252 U.S. 189; *Commissioner of Internal Revenue* v. *Fleming*, 82 F. 2d 321 (C.A. 5); and *Nicholas* v. *Fifteenth Street Inv. Co.*, 105 F. 2d 289 (C.A. 10), merely emphasize that the Sixteenth Amendment grants power to tax "income" alone, not "capital".

did not share in the profits of the business. The memberships were nonassignable and could be revoked at any time by the board of directors "for any cause", in which case the membership fees would not be refunded (Pet. App. 13). Very few members ever attended a membership meeting (Pet. App. 11, 14-15) and neither the member nor his estate was assured of a share in any distribution in the event of liquidation (Pet. App. 31-32). In short, as the court of appeals aptly pointed out (Pet. App. 15), the members received nothing of substance in exchange for their fees "other than the privilege of buying goods at a discount". Accordingly, taxpayer's contention that the fees were received in exchange for stock rather than for services rendered, is without merit.

The instant decision is not in direct conflict with the decision of any other court of appeals. The alleged impact of the decision on all other nonstock companies in the United States (Pet. 10-12) ignores the care taken by the court of appeals to limit its holding to the facts of this (and the related) case (Pet. App. 14-15).

CONCLUSION

The decision of the court below is correct, and, in any event, presents no issue warranting review by this Court. The petition for certiorari should be denied.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.
DAVID O. WALTER,
RALPH A. MUOIO,
Attorneys.

MARCH, 1964.

U. S. GOVERNMENT PRINTING OFFICE